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No. 27

IN THE

Supreme Court of the United States

October Term, 1940.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

against

Paul R. G. Horst,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE RESPONDENT.

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BRIEF FOR RESPONDENT.

Opinions Below.

The opinions below are those of the Board of Tax Appeals, reported in 39 B. T. A. 757, printed in the record herein at pages 14-19; and that of the Circuit Court of Appeals, reported in 107 F. (2d) at page 906, printed in the record herein at pages 26-28.

Jurisdiction of this Court.

The jurisdiction of this Court arises under Section 240 (a) of the Judicial Code and this Court's grant of a writ of certiorari herein on April 8, 1940.

Statement of the Case.

This case presents a single question, arising out of two income tax returns of the respondent, one for the year 1934, the other for the year 1935.

On August 10, 1934, the respondent detached from various coupon bonds he owned negotiable interest coupons amounting to $25,182.50, maturing respectively from five to sixteen weeks later, and then made an outright gift of these coupons to his son, who later in 1934 collected these coupons as they matured and reported them in his own return for 1934 as part of his own income for that year (R. 15).

In 1935 the respondent made a similar gift to his son of similar unmatured coupons cut by respondent from bonds he owned. These 1935 coupons had a par value of $37,032.50, but only $25,495.00 was collected thereon by the son, who reported the amount collected therefrom in his own income tax return for that year (R. 15).

The respondent, whose returns were made each year on a cash basis (R. 15), did not report in either year as part of his own income the amount of these coupons which he had so given away before their maturity (R. 15).

The Commissioner later assessed deficiencies in income against the respondent on account of these coupons of $25,182.50 for 1934 and of $22,360.00* for 1935, on the

* The difference between the $25,495 reported by the son and the $22,360 deficiency assessed against the respondent is apparently due to some offsetting items credited to the respondent by the Commissioner (R. 15).

sole ground that the bonds themselves had not been transferred to the son with the coupons (R. 6 and 11). Corresponding deficiencies in tax were assessed by the Commissioner against the respondent of $13,903.09 and interest for 1934 (R. 12) and of $12,376.20 and interest for 1935 (R. 6).

The respondent petitioned the Board of Tax Appeals for review of these several deficiency assessments. The Board statedly declined to follow the decision of the Circuit Court of Appeals for the Seventh Circuit in *Rosenwald* v. *Commissioner,* 33 F. (2d) 423, an identical case (R. 16); and sustained the ruling of the Commissioner (R. 18).

Three members of the Board, however, dissented from its ruling (R. 18-19).

The respondent then appealed to the Circuit Court of Appeals for the Second Circuit, which unanimously reversed the order of the Board of Tax Appeals.

The Circuit Court of Appeals cited in support of its decision the *Rosenwald* case (33 F. (2d) 423), and its own earlier decision in *Matchette* v. *Helvering,* 81 F. (2d) 73, and distinguished the cases on which the petitioner relied, on the basis that the gift of the coupons in this case was an outright completed gift of a separate piece of property, not dependent on any further act of the donor, or even on the donor's continuing to hold the bonds.

The Court below pointed out, too, that in such cases as *Lucas* v. *Earl,* 281 U. S. 111; *Burnett* v. *Leininger,* 285 U. S. 136 and *Bing* v. *Bowers,* 22 F. (2d) 450 and 26 F. (2d) 1017, the future income given away was not independent

and completely severed from the principal, as is the case with the coupons in the case at bar, but was dependent in each instance on future acts of the donor; in the *Lucas* case on his subsequent earnings, in *Burnet* v. *Leininger* on his continuing in a partnership, in *Bing* v. *Bowers* because the donor had given up no interest in the land, had created no rent charge thereon, and had in fact retained control over the net income he had purported to grant to another (R. 28).

It mentioned, too, that this Court had itself pointed out this distinction in *Blair* v. *Commissioner,* 300 U. S. 5 (R. 28).

Subsequently this Court decided the case of *Helvering* v. *Clifford,* 309 U. S. 331, on which the petitioner principally relies, and which seems to us inapplicable to the case at bar.

Summary of the Argument.

The controlling facts in the case at bar are that the unmatured coupons given outright by the respondent to his son were independent negotiable instruments; that they never became income of the respondent, who made his returns on the cash basis; and that the respondent's retention of the bonds, shorn of the coupons, left to the respondent no vestige of ownership or control over the coupons so given away by him.

The decisions of the two different Circuit Courts of Appeal which have passed on the point presented agree that the coupons so given away before maturity are not income of the donor.

The case differs materially in its essentials from that presented in *Helvering* v. *Clifford,* 309 U. S. 331, and the decision in the case at bar is supported by this court's decision in *Blair* v. *Commissioner,* 300 U. S. 5, 11-14.

ARGUMENT.

I.

The coupons given by the respondent to his son before their maturity were independent negotiable instruments complete in themselves, and by the gift became the absolute property of the donee free from any control by the donor by reason of his retention of the bonds from which they had been detached.

Clark v. *Iowa City,* 20 Wall. 583;
Hartman v. *Greenhow,* 102 U. S. 672;
Koshkonong v. *Burton,* 104 U. S. 668;
Clokey v. *Evansville & T. H. R. R. Co.* 16 App. Div. 304;
Pratt v. *Higginson,* 230 Mass. 256.

This long settled doctrine—the controlling feature of the present case—is dealt with by the petitioner in the most casual manner by the statement in his brief

> "The fact that the interest herein was embodied in separately disposable coupons should not make any difference." (Petitioner's Brief, p. 5)

and the subsequent statement:

> "We respectfully submit that the difference is a purely formal one." (Petitioner's Brief, p. 8)

In our view, this difference between absolute and merely contingent ownership is both substantial and controlling. And so it has appeared, on another occasion, to the Commissioner, who ruled in 1939 that a purchaser of unmatured coupons must pay income tax on whatever he collected above what he paid for the coupons.

I. T. 3312, C. B. 1939-2, 168.

And in this particular instance the donee reported the entire amount collected as his income (R. 15).

II.

The two cases on this point in the Circuit Courts of Appeal agree that coupons so given away before their maturity are not income of the donor, but of the donee.

Rosenwald v. *Commissioner,* 33 F. (2d) 423;
Horst v. *Commissioner,* 107 F. (2d) 906;

See also, for similar rulings:

Matchette v. *Helvering,* 81 F. (2d) 73;
Williston v. *Commissioner,* 2 Mass. A. T. B. 663;
Schoonmaker v. *Commissioner,* 39 B. T. A. 496;
I. T. 3312, C. B. 1939-2, 168.

III.

The case at bar does not come within the doctrines laid down in *Helvering* v. *Clifford,* 309 U. S. 331, but within those declared in *Blair* v. *Commissioner,* 300 U. S. 5, 11-14.

Subsequent to the decision of the present case by the Circuit Court of Appeals, this Court handed down its decision in the case of *Helvering* v. *Clifford,* 309 U. S. 331, on which the petitioner places his main reliance.

Several features of the *Clifford* case distinguish it sharply from the case at bar, though apparently these crucial differences have not impressed counsel for the petitioner.

In the *Clifford* case there were the following striking features, none of which exist in the case at bar:

There was there no separate thing separated and completely transferred.

What was transferred there, and that only *sub modo,* was net income from a trust fund over which Mr. Clifford retained absolute control. He might easily, under the extensive powers reserved to himself, invest it in such a way that there might be no net income therefrom during the specified period. That was left to his own absolute discretion. That is a very different thing from an absolute transfer of a specific coupon.

Moreover, in the *Clifford* case, Mr. Clifford also retained control even over whatever net income there might be, under the striking provision that he was to pay over to his wife during the continuance of the trust, the whole

or such part of the net income as he "in his absolute discretion" might determine. That provision practically nullified any absolute right on her part to get the income.

Raymond v. *Tiffany,* 59 Misc. 283.

Any income paid her became a completed gift only when Mr. Clifford exercised his discretion in her favor, after the income had been collected by him.

This Court, in its opinion in the *Clifford* case, further pointed out that Mr. Clifford "retained the substance of "full enjoyment of all the rights which previously he had "in the property." (309 U. S. 331, 336.)

As this Court indicated in its opinion in the *Clifford* case, it was the combination of all the elements appearing in that case that constituted the appropriate foundation for the finding there sustained (309 U. S. 331, 336).

The situation here is radically different. The coupons given by Mr. Horst were separate negotiable instruments.

Clark v. *Iowa City,* 20 Wall. 583;
Hartman v. *Greenhow,* 102 U. S. 672;
Koshkonong v. *Burton,* 104 U. S. 668.

Mr. Horst had parted with them absolutely and completely, before their maturity.

His ownership of the bonds, shorn of their coupons, gave him not the slightest control over the donated coupons.

He could sell or give the bonds, without the donated coupons, to some third person, and such third person would have no more control over the donated coupons than he himself had.

He could, if he wished, destroy the bonds from which the coupons had been clipped, but the coupons would none the less remain valid in the hands of his donee totally unaffected by what he did with or to the bonds from which they had been detached.

In a parallel case before the Massachusetts Appellate Tax Board under the similar Massachusetts Statute it was pointed out, orally (as we are informed by counsel in that case), that if the donor gave the unmatured coupons to one, and gave the bond without the coupons to another, there would certainly be difficulty about charging the separate donee of the bond with the income collected on the coupon, and no answer to the suggestion was forthcoming.

The Massachusetts Board, in a studied opinion, declined to tax the owner of the naked bonds with the income received by his donee of the coupons.

Williston v. *Commissioner,* 2 Mass. A. T. B. 663.

In a footnote to page 9 of his brief, the petitioner suggests, as he suggested orally in the Circuit Court of Appeals, that the donor, if he made his returns on the accrual basis, might perhaps have been taxed on the accrual on the coupons up to the time of gift. The answer, of course, is that he made his returns on the cash basis, and did not receive any of that accruing income.

It was suggested on the argument of this case before the Circuit Court of Appeals that this respondent might have sold the coupons at a discount, and this petitioner was asked by the Court: "On what amount would you then tax him?" The answer was, and had to be, on the amount he got for them. So to the following question: "And when

he got nothing for them, on what would you tax him?" the petitioner had no answer to offer.

The Commissioner had already ruled that the transferee of the coupon must report as his own income the amount collected thereon, less what he had paid for the coupon.

I. T. 3312, C. B. 1939-2, 168.

The entire argument for the petitioner seeks to ignore the fundamental fact that the coupon is a wholly independent and separate obligation from the bond, which, when parted with, is entirely beyond the control of the owner of the bond.

The retention of some remaining control over the coupon by the owner of the bond would be of the essence of the case to bring it within the principles of any of the decisions on which the petitioner relies. Here the gift was absolute, leaving no vestige of any such control.

There is but little to add to the argument set forth in the opinion of the Circuit Court of Appeals.

Counsel for the petitioner have twice quoted a phrase from this Court's opinion in *Reinecke* v. *Smith,* 289 U. S. 172, 177. The first time they quoted it (on page 5 of their brief) they omitted the controlling word "such" with which the phrase opened. The second time (on page 9 of their brief) they kept the word "such" in, but omitted to mention what that restrictive word referred to. They have thus apparently given to that quotation a force which does not belong to it, and which this Court later rejected as a misconstruction of it.

Blair v. *Commissioner,* 300 U. S. 5, 11-14.

The case at bar comes directly within that last cited decision.

IV.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

HARRY H. WIGGINS,
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SELDEN BACON,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

No. 27.—October Term, 1940.

Guy T. Helvering, Petitioner, *vs.* Paul R. G. Horst.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 25, 1940.]

Mr. Justice Stone delivered the opinion of the Court.

The sole question for decision is whether the gift, during the donor's taxable year, of interest coupons detached from the bonds, delivered to the donee and later in the year paid at maturity, is the realization of income taxable to the donor.

In 1934 and 1935 respondent, the owner of negotiable bonds, detached from them negotiable interest coupons shortly before their due date and delivered them as a gift to his son who in the same year collected them at maturity. The Commissioner ruled that under the applicable § 22 of the Revenue Act of 1934, 48 Stat. 680, 686, the interest payments were taxable, in the years when paid, to the respondent donor who reported his income on the cash receipts basis. The circuit court of appeals reversed the order of the Board of Tax Appeals sustaining the tax. 107 F. (2d) 906; 39 B. T. A. 757. We granted certiorari, 309 U. S. 650, because of the importance of the question in the administration of the revenue laws and because of an asserted conflict in principle of the decision below with that of *Lucas* v. *Earl,* 281 U. S. 111, and with that of decisions by other circuit courts of appeals. See *Bishop* v. *Commissioner,* 54 F. (2d) 298; *Dickey* v. *Burnet,* 56 F. (2d) 917, 921; *Van Meter* v. *Commissioner,* 61 F. (2d) 817.

The court below thought that as the consideration for the coupons had passed to the obligor, the donor had, by the gift, parted with all control over them and their payment, and for that reason the case was distinguishable from *Lucas* v. *Earl, supra* and *Burnet* v. *Leininger,* 285 U. S. 136, where the assignment of compensation for services had preceded the rendition of the services, and where the income was held taxable to the donor.

The holder of a coupon bond is the owner of two independent and separable kinds of right. One is the right to demand and receive at maturity the principal amount of the bond representing capital investment. The other is the right to demand and receive interim payments of interest on the investment in the amounts and on the dates specified by the coupons. Together they are an obligation to pay principal and interest given in exchange for money or property which was presumably the consideration for the obligation of the bond. Here respondent, as owner of the bonds, had acquired the legal right to demand payment at maturity of the interest specified by the coupons and the power to command its payment to others which constituted an economic gain to him.

Admittedly not all economic gain of the taxpayer is taxable income. From the beginning the revenue laws have been interpreted as defining "realization" of income as the taxable event rather than the acquisition of the right to receive it. And "realization" is not deemed to occur until the income is paid. But the decisions and regulations have consistently recognized that receipt in cash or property is not the only characteristic of realization of income to a taxpayer on the cash receipts basis. Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *Corliss* v. *Bowers,* 281 U. S. 376, 378. Cf. *Burnet* v. *Wells,* 289 U. S. 670.

In the ordinary case the taxpayer who acquires the right to receive income is taxed when he receives it, regardless of the time when his right to receive payment accrued. But the rule that income is not taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income, can escape taxation because he has not himself received payment of it from his obligor. The rule, founded on administrative convenience, is only one of postponement of the tax to the final event of enjoyment of the income, usually the receipt of it by the taxpayer, and not one of exemption from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of money or property. Cf. *Aluminum Castings Co.* v. *Routzahn,*

282 U. S. 92, 98. This may occur when he has made such use or disposition of his power to receive or control the income as to procure in its place other satisfactions which are of economic worth. The question here is, whether because one who in fact receives payment for services or interest payments is taxable only on his receipt of the payments, he can escape all tax by giving away his right to income in advance of payment. If the taxpayer procures payment directly to his creditors of the items of interest or earnings due him, see *Old Colony Trust Co.* v. *Commissioner, supra; Bowers* v. *Kerbaugh Empire Co.*, 271 U. S. 170; *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, or if he sets up a revocable trust with income payable to the objects of his bounty, §§ 166, 167, Revenue Act of 1934, *Corliss* v. *Bowers, supra;* cf. *Dickey* v. *Burnet,* 56 F. (2d) 917, 921, he does not escape taxation because he did not actually receive the money. Cf. *Douglas* v. *Willcuts,* 296 U. S. 1; *Helvering* v. *Clifford,* 309 U. S. 331.

Underlying the reasoning in these cases is the thought that income is "realized" by the assignor because he, who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants. The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them. Cf. *Burnet* v. *Wells, supra.*

Although the donor here, by the transfer of the coupons, has precluded any possibility of his collecting them himself he has nevertheless, by his act, procured payment of the interest, as a valuable gift to a member of his family. Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of the income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such non-material satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son. Even though he never receives the money he derives money's worth from the disposition of the coupons which he has used as money or money's worth in the procuring of a satis-

faction which is procurable only by the expenditure of money or money's worth. The enjoyment of the economic benefit accruing to him by virtue of his acquisition of the coupons is realized as completely as it would have been if he had collected the interest in dollars and expended them for any of the purposes named. *Burnet* v. *Wells, supra.*

In a real sense he has enjoyed compensation for money loaned or services rendered and not any the less so because it is his only reward for them. To say that one who has made a gift thus derived from interest or earnings paid to his donee has never enjoyed or realized the fruits of his investment or labor because he has assigned them instead of collecting them himself and then paying them over to the donee, is to affront common understanding and to deny the facts of common experience. Common understanding and experience are the touchstones for the interpretation of the revenue laws.

The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it. We have had no difficulty in applying that proposition where the assignment preceded the rendition of the services, *Lucas* v. *Earl, supra; Burnet* v. *Leininger, supra,* for it was recognized in the *Leininger* case that in such a case the rendition of the service by the assignor was the means by which the income was controlled by the donor and of making his assignment effective. But it is the assignment by which the disposition of income is controlled when the service precedes the assignment and in both cases it is the exercise of the power of disposition of the interest or compensation with the resulting payment to the donee which is the enjoyment by the donor of income derived from them.

This was emphasized in *Blair* v. *Commissioner,* 300 U. S. 5, on which respondent relies, where the distinction was taken between a gift of income derived from an obligation to pay compensation and a gift of income-producing property. In the circumstances of that case the right to income from the trust property was thought to be so identified with the equitable ownership of the property from which alone the beneficiary derived his right to receive the income and his power to command disposition of it that a gift of the income by the beneficiary became effective only as a gift of his ownership of the property producing it. Since the gift was deemed

to be a gift of the property the income from it was held to be the income of the owner of the property, who was the donee, not the donor, a refinement which was unnecessary if respondent's contention here is right, but one clearly inapplicable to gifts of interest or wages. Unlike income thus derived from an obligation to pay interest or compensation, the income of the trust was regarded as no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away. *Blair* v. *Commissioner, supra,* 12, 13 and cases cited. See also *Reinecke* v. *Smith,* 289 U. S. 172, 177. We have held without deviation that where the donor retains control of the trust property the income is taxable to him although paid to the donee. *Corliss* v. *Bowers, supra.* Cf. *Helvering* v. *Clifford, supra.*

The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid. See, *Corliss* v. *Bowers, supra,* 378; *Burnet* v. *Guggenheim,* 288 U. S. 280, 283. The tax laid by the 1934 Revenue Act upon income "derived from . . . wages or compensation for personal service, of whatever kind and in whatever form paid, . . . ; also from interest . . . " therefore cannot fairly be interpreted as not applying to income derived from interest or compensation when he who is entitled to receive it makes use of his power to dispose of it in procuring satisfactions which he would otherwise procure only by the use of the money when received.

It is the statute which taxes the income to the donor although paid to his donee. *Lucas* v. *Earl, supra; Burnet* v. *Leininger, supra.* True, in those cases the service which created the right to income followed the asignment and it was arguable that in point of legal theory the right to the compensation vested instantaneously in the assignor when paid although he never received it; while here the right of the assignor to receive the income antedated the assignment which transferred the right and thus precluded such an instantaneous vesting. But the statute affords no basis for such "attenuated subtleties." The distinction was explicitly rejected as the basis of decision in *Lucas* v. *Earl.* It should be rejected here, for no more than in the *Earl* case can the purpose of the statute to tax the income to him who earns, or creates and enjoys it be es-

caped by "anticipatory arrangements however skilfully devised" to prevent the income from vesting even for a second in the donor.

Nor is it perceived that there is any adequate basis for distinguishing between the gift of interest coupons here and a gift of salary or commissions. The owner of a negotiable bond and of the investment which it represents, if not the lender, stands in the place of the lender. When, by the gift of the coupons, he has separated his right to interest payments from his investment and procured the payment of the interest to his donee, he has enjoyed the economic benefits of the income in the same manner and to the same extent as though the transfer were of earnings and in both cases the import of the statute is that the fruit is not to be attributed to a different tree from that on which it grew. See *Lucas* v. *Earl, supra,* 115.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 27.—OCTOBER TERM, 1940.

Guy T. Helvering, Petitioner, *vs.* Paul R. G. Horst.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 25, 1940.]

The separate opinion of Mr. Justice McREYNOLDS.

The facts were stipulated. In the opinion of the court below the issues are thus adequately stated—

"The petitioner owned a number of coupon bonds. The coupons represented the interest on the bonds and were payable to bearer. In 1934 he detached unmatured coupons of face value of $25,182.50 and transferred them by manual delivery to his son as a gift. The coupons matured later on in the same year, and the son collected the face amount, $25,182.50, as his own property. There was a similar transaction in 1935. The petitioner kept his books on a cash basis. He did not include any part of the moneys collected on the coupons in his income tax returns for these two years. The son included them in his returns. The Commissioner added the moneys collected on the coupons to the petitioner's taxable income and determined a tax deficiency for each year. The Board of Tax Appeals, three members dissenting, sustained the Commissioner, holding that the amounts collected on the coupons were taxable as income to the petitioner."

The decision of the Board of Tax Appeals was reversed and properly so, I think.

The unmatured coupons given to the son were independent negotiable instruments, complete in themselves. Through the gift they became at once the absolute property of the donee, free from the donor's control and in no way dependent upon ownership of the bonds. No question of actual fraud or purpose to defraud the revenue is presented.

Neither *Lucas* v. *Earl*, 281 U. S. 111, nor *Burnet* v. *Leininger*, 285 U. S. 136, support petitioner's view. *Blair* v. *Commissioner*, 300

U. S. 5, 11, 12, shows that neither involved an unrestricted completed transfer of property.

Helvering v. *Clifford,* 309 U. S. 331, 335, 336, decided after the opinion below, is much relied upon by petitioner, but involved facts very different from those now before us. There no separate thing was absolutely transferred and put beyond possible control by the transferror. The court affirmed that Clifford, both conveyor and trustee, "retained the substance of full enjoyment of all the rights which previously he had in the property." "In substance his control over the corpus was in all essential respects the same after the trust was created as before." "With that control in his hands he would keep direct command over all that he needed to remain in substantially the same financial situation as before."

The general principles approved in *Blair* v. *Commissioner,* 300 U. S. 5, are applicable and controlling. The challenged judgment should be affirmed.

The Chief Justice and Mr. Justice Roberts concur in this opinion.

END